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**PRIDE Industries**

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**Date:** 12/13/2004

**Re:** Comments on proposed regulations of the **CC:** Janet Yandik and John Heyer  
Committee for Purchase. Docket 2004- (703) 603-0655  
01-01 RIN 3037-AA00



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December 13, 2004

PRIDE Industries, Inc. (PRIDE) appreciates this opportunity to provide its comments in opposition to the proposed notice of rulemaking [Docket No. 2004-01-01] by the President's Committee for Purchase From People Who Are Blind or Severely Disabled (Committee). PRIDE is one of the nation's largest employers of people with disabilities and employs more than 2,700 people with disabilities including those employees providing services under the Javits-Wagner-O'Day (JWOD) Program.

PRIDE does share the Committee's concern about any organization that fails to fulfill its stated mission by abusing its nonprofit status. However, the proposed regulations will impact all JWOD participating nonprofit entities and, are not the proper mechanism to effect the changes desired by the Committee. This is especially true in light of the Committee's own comment that "the overwhelming majority of JWOD....nonprofit agencies operate in an ethical and accountable manner" and it is only "isolated instances" of alleged wrongdoing that have "prompted the need for explicitly stated standards."

More specifically, PRIDE operates under strict internal board of director (Board) oversight, obtains independent third party compensation recommendation and review, is CARF accredited, complies with all Internal Revenue Code requirements and, as of the last quarter of 2004 is required to comply with California Government Code Section 12586 (Senate Bill 1262) which requires California nonprofit corporations to comply with certain Sarbanes-Oxley Act parameters.

After a review of other federal regulatory systems, applicable state laws, the JWOD statute and its implementing regulations, the legislative history of the JWOD Act, and federal case law PRIDE has concluded that the JWOD Act does not confer upon the Committee the authority to impose these proposed regulations regarding executive compensation and corporate governance.

However, even if it is determined that the Committee has not exceeded its authority, PRIDE takes the position that the proposed rules contained within 41 CFR 51-2.10 should be withdrawn as they do not further the Committee's intended action of

PRIDE Industries  
December 13, 2004

- 1 -



strengthening Boards' composition and oversight, and protecting against excessive executive compensation. The proposed regulations have not been thoughtfully written nor thoroughly examined as to the burden and expense they will impose on nonprofit entities. Further, the proposed regulations will actually weaken the long-term stability and ultimate viability of the nonprofit entities responsible for providing community rehabilitation programs.

## **1. Federal Regulatory Systems and Applicable State Laws Currently Regulate Nonprofit Corporations.**

501 (c)(3) nonprofit corporations are primarily regulated by the federal government through the Internal Revenue Service (IRS). The IRS regulates their financial and governance affairs, including executive compensation, and has an aggressive enforcement arm. The IRS can investigate improprieties and impose severe penalties (intermediate sanctions) on any non-compliant 501(c)(3) nonprofit corporation. The IRS has the awesome power to revoke a corporation's nonprofit status for violations such as the prohibition against private inurement ("private benefit"). Additionally, every 501(c)(3) nonprofit corporation must file an annual Form 990 (990), which publicly discloses its finances, including administrative expenses and executive compensation.

Each nonprofit corporation is organized under a state law. The Attorneys General and their state governmental departments enforce against abuses of charitable trusts and activities. Some states, such as California, have passed Sarbanes Oxley Act types of laws that include requirements regarding executive compensation and Board approvals, as well as the establishment of independent audit committees.

There is no purpose to and nothing to be gained by additional oversight by the Committee and the duplication simply adds to the burden of reporting. Should the Committee have concerns about the activities of any nonprofit entity providing services or goods under the JWOD Program, it could simply notify the state Attorney General and the IRS of those concerns.

## **2. The Committee's Authority to Regulate Nonprofit Internal Management is Limited.**

Although Section 2 of the JWOD Act (41 U.S.C. § 47), which sets forth the express powers and duties Congress vested in the Committee, seem to grant the Committee broad authority to carry out the purposes of the Act, the authority is restricted to rules that are "necessary" to achieve the JWOD Act's central purpose: to increase employment and training opportunities for persons who are blind or have other severe disabilities through the purchase of commodities and services from nonprofit agencies employing persons who are blind or have other severe disabilities. There is no demonstrable, direct connection between the proposed regulations and the JWOD Act's stated purpose as summarized:



- Establishment of procurement list for publication in the Federal Register of commodities and services produced by a qualified nonprofit agency for the blind or severely handicapped;
- Determine fair market price of commodities and services contained on procurement list with the power to revise the price from time to time;
- Designate central non-profit agency or agencies to facilitate distribution of orders of the Government for commodities and services on the procurement list among qualified nonprofit agencies for the blind and severely handicapped;
- Make rules and regulations regarding specifications for commodities and services on the procurement list, the time of their delivery, and such other matters as may be necessary to carry out the purposes of this Act;
- Make continuing study and evaluation of its activities to assure effective and efficient administration of this Act; and
- The Committee may prescribe regulations regarding the priority in the purchase by the Government of commodities and services offered for sale by qualified nonprofit agencies for the blind and severely handicapped.

The proposed regulations do not directly advance the overall stated purpose of the JWOD Act and therefore exceed the intentions of the legislature.

In fact, it is PRIDE's position that the proposed regulations will have a negative impact on the growth and stability of nonprofit entities that employ, train and provide opportunities for many citizens who are blind and disabled. PRIDE, like many successful nonprofit entities, have grown over the past years and require sophisticated management leadership and expertise to continue to operate successfully and efficiently in a more and more competitive market while still meeting its nonprofit mission and the requirements as a JWOD participant. Executive compensation levels must be in alignment with the size, complexity, success and location of each nonprofit entity in order to attract and retain the most experienced and talented personnel (the "best and the brightest").

### **3. JWOD's Legislative History Does Not Support Regulation of Nonprofit Internal Management.**

PRIDE is in agreement with the findings on this topic as submitted by Goodwill International on behalf of all the Goodwills.

### **4. Specific Comments on Proposed Rulemaking: 41 CFR Part 51-2.10 Program Participant Governance.**

*51-2.10(a) (6) Turns over Board, or other governing authority, membership on a recurring schedule;*



**Comment:** The bylaws of a nonprofit corporation provide the composition and term of the Board and its members and the bylaws are governed by state corporate law. In addition to this section lacking clarity and failing to define "turn over" or "recurring schedule," it is also unnecessary and potentially devastating to the continuity of the mission and to the power of community involvement in the nonprofit entity. Volunteer Boards are most often comprised of community leaders and are challenging to assemble; once in place the Board composition must be respected and nurtured. It falls upon the Board itself and its duty of loyalty and fiduciary responsibility to choose new Board members who are able to govern the corporation at the highest possible levels of business and ethics. Compliance with state nonprofit corporate laws is more than sufficient and this section should be deleted.

*51-2.10(a)(8) Has at least one financial expert serving;*

**Comment:** This section lacks a definition of "financial expert." It may not be possible for a nonprofit entity to locate a volunteer Board member to fill this requirement and, if there is to be Board "turn over" as suggested by these proposed regulations, then the problem would be compounded. It is up to the Board to ensure that it has the expertise it requires, either internally or through external assistance, to fulfill its fiduciary responsibility.

*51-2.10(a) (9) Publishes and makes public the minutes of Board, or other governing authority, meetings.*

**Comment:** This section will chill open Board discussion and activity. The state in which the nonprofit entity is incorporated is responsible for auditing corporate activity and providing oversight of the nonprofit dollars. There is no rationale or direct connection between the purpose of the JWOD Act, the authority of the Committee and the requirement that Board meeting minutes be published, and until the Committee provides such a rationale and connection, this section should be removed.

*51-2.10-(b) In assessing the reasonableness of executive and other employee compensation, the Committee will consider:*

In general, there is no information about the manner in which the Committee will review, process and weight each of the parameters set out in this section. Without some sense of the rationality of these parameters and without some objective measurable criteria, this section is swallowed in dangerous subjectivity and should be removed.

*51-2.10-(b)(1) The size and complexity of the central nonprofit agency's or nonprofit agency's charter or mission;*

**Comment:** PRIDE sees no rational, analytic or objective way in which to provide a determination of the complexity of our mission. Our mission, to create jobs for people with disabilities, is as simple as an assignment of a worker to our production floor or as



complex as all of the steps required over a number of years to earn a large contract award and provide all the myriad of details that result in successful performance. The Committee has not provided any objective criteria it would use to assess this complexity. Is the complexity going to be measured by the geographic diversity of the work, the diversity or complexity of the work itself, the severity of the disabilities of our employees or some other criteria?

*51-2.10 (b) (3) The technical and professional qualifications required for positions in the central nonprofit agency or nonprofit agency;*

**Comment:** This requires the Committee to evaluate the capabilities of each PRIDE employee. PRIDE has hundreds of documents and job descriptions that provide the qualification levels required for each position. The burden and expense on PRIDE to compile and copy the requested materials would be immense. Of course, the man-hours required to amass the information would be substantial. Both money and time would be diverted from our mission in order to comply with a regulation the meaning and value of which lacks clarity of purpose and should be removed.

*51-2.10 (b) (4) Compensation packages paid at comparable central nonprofit agencies or nonprofit agencies;*

**Comment:** Although PRIDE will not be required to compile this information under this section, unless the Committee can adequately compare "apples to apples," this exercise will be fruitless. Each corporation is very different as to, for example, number of employees, locations, gross and net revenues, etc., and such a comparison will be complex with great margin for erroneous conclusions. If this section is not withdrawn, the Committee's comparisons must be published to the nonprofit entities for comment prior to including it in any objective weighing process.

*51-2.10(b)(6) The extent to which the central nonprofit agency's on nonprofit agency's executive compensation packages exceed the total compensation offered to the typical, highest paid (excluding any retention allowances and Presidential rank awards), senior executive service, career Federal government employee; and*

**Comment:** PRIDE is concerned that, in addition to this section having no direct connection to, or being necessary for the advancement of the JWOD Program's stated purpose, the overall impact will be to weaken PRIDE's ability to attract and retain the "best and brightest" management leaders. As the size and complexity of a nonprofit corporation increases, and the greater the need for more sophisticated, educated and experienced professionals. These individuals could likely deserve and demand compensation in excess of the oddly chosen ceiling amount referenced in this section.

The comparison of a nonprofit and its mission to the federal government employees who are tasked with running various government agencies in accordance with strict guidelines and rules is nonsensical. The Chief Executive Officer of a nonprofit does not have the luxury of considering him or herself as a lifetime, tenured, "career" employee. The CEO



is hired and sits at the pleasure of the Board and can be terminated by the Board at any time. The Committee has erred drastically in trying to compare a government employee to a private sector employee. In addition, the Committee is attempting to usurp one of the most important jobs of the Board and may actually interfere with the Board's ability to obtain the type of leadership and management the Board determines is in the best interests of the nonprofit corporation for which the Board has a fiduciary obligation.

Furthermore, in the preamble to the proposed regulations, the Committee states that the current total compensation of the highest paid senior career federal employee is \$207,000. We do not know what is included in that figure and what the work requirements and hours are and how they might compare or relate to the job of a corporate leader. The Committee must provide detailed information regarding this number.

*51-2.10 (b) (7) For only nonprofit agencies, the median compensation package for the nonprofit agency's direct labor hour workers and how that median compares to the compensation packages offered to executives.*

**Comment:**

The intent of this proposed section escapes PRIDE. On its face, this section appears only useful to embarrass nonprofit entities, their Boards and their executives by comparing executive salaries to those of hourly employees. Will the Committee also require the resumes of each of these persons? As its mission, PRIDE hires those employees who are not competitive in the community's labor pool. It is obvious that there is a large percentage difference between such an employee and the CEO. What is the Committee's intention?

Shared research reveals that for-profit CEOs throughout the nation are paid 300 times the average direct labor employee (or 30,000 %). Does the Committee want to see that the nonprofit percentage would be less than the for-profit percentage? If so, how much less is acceptable to the Committee?

This proposed section is a criterion without a foundational principle and absent a clear explanation, should be deleted.

*51-2.10 (c)(2) Qualified nonprofit agencies participating in the JWOD Program must certify that the governance standards set forth in paragraphs (a) and (b) of this section have or have not yet been met on the annual certification form required by 51-4.3(a) of this chapter.*

**Comment:** This section requires that our Board certify that the Committee has performed all of the standards in 51-2.10 (b). 51-2.10 (b) states, "In assessing the reasonableness of executive and other employee compensation, the Committee will consider...". How can PRIDE's Board certify that the Committee has considered anything? Unlike section (a), section (b) does not specify actions by the nonprofit entity itself. Instead, it specifies what the Committee will consider in looking at executive



compensation. In order to comply with this section the Committee would need to provide our Board with a report that documents that they considered all that is entailed in 51-2.10(b) (1) through (7) in order for our Board to even consider signing the annual certification. Furthermore, while the preamble to the proposed regulations state that the Committee would see compensation above \$207,000 to be excessive, the regulations itself does not specify that the Committee would only carry out its consideration of executive compensation that exceeded the threshold, but in fact would carry out 51-2.10(b)(1)-(7) on all participating agencies, regardless of the compensation level. Therefore the Committee would be obligated to provide this report annually to all participating agencies the number of which is legion. The practicality of carrying out this proposed regulation is questionable. The Board would first have to submit a proposed compensation amount for CEOs and key employees to the Committee along with documentation for items listed in 51-2.10(b). The Committee would need to be extremely timely in reviewing all submissions and return the reports to each Board with their approval or disapproval of the proposed compensation level. Only then would the Board be able to consider signing the annual certification. The Committee would have to provide some sort of certification itself as to the use of the information provided to it and the process by which it evaluated such information along with its rationale of final findings. It is highly unlikely that the Committee can perform all that is entailed in 51-2.10(b) within a 30 day time period.

## **Comments on Certifications and Required Determinations**

### **1. Regulatory Flexibility Act**

The proposed regulations violate the Regulatory Flexibility Act. The impact of the proposed regulations not only creates additional reporting and record keeping burdens, they also create serious challenges to the long-term viability of nonprofit agencies. The statement that "There are no known regulatory alternatives which would accomplish the objectives of the Javits-Wagner O'Day Act", is erroneous because the proposed regulations are duplicative of the IRS under whose authority nonprofit executive compensation is reviewed and intermediate sanctions are assessed if compensation levels are deemed excessive. PRIDE joins the other commenting nonprofit entities in requesting that an initial regulatory flexibility analysis be prepared as specified in section 603 of Title 5 U.S.C.

### **2. Executive Order 12866**

PRIDE comments on section (b) that the IRS has the authority to rule on and implement intermediate sanctions on compensation levels found to be excessive. The IRS does not set a pre-defined level for compensation and could find that in some instances \$207,000 would be excessive compensation, thereby creating a potential conflict between regulating agencies. Furthermore, the proposed governance standards go well beyond the JWOD Act.



### 3. Paperwork Reduction Act

A review of the proposed changes to Forms 403 and 404 do not instantly reveal the additional burden on PRIDE. However, the preparation of 990 information earlier than the 990 is required by the IRS will create duplicative and unnecessary activity since audited information would not yet be available.

Further, PRIDE cannot quantify the amount of time and paperwork required to obtain, evaluate and further clarify information we must obtain from the Committee under 51-2.10 (b) in order for our Board to certify such information.

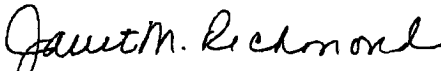
More importantly, however, is that absent clarification of the proposed regulations through the full public comment process, the OMB must not accept the revised paperwork because the substance of proposed regulations sits within the form revisions. PRIDE is concerned that any acceptance of the form revisions will act as an acceptance of the substance of the proposed regulations.

### Conclusion

PRIDE contends that the proposed regulations are not necessary for the proper performance of the function of the Committee in carrying out the intent of the JWOD Act. There are current state and federal laws and regulations that are available to be applied as enforcement tools against inappropriate or unlawful behavior by a nonprofit corporation.

For the reasons stated throughout this document, PRIDE believes the proposed regulations should be withdrawn.

Respectfully submitted,



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